

Internal Revenue Service
District Director
2 Cupania Circle
Monterey Park, CA 91755

Department of the Treasury
Western Key District

Date: OCT 14 1997

Employer Identification
Number:

Case Number:

Refer Reply To:

Person to Contact:

Contact Telephone Number:

CERTIFIED MAIL

Dear Applicant:

We have considered your application for exemption from Federal income tax as an organization described under section 501(c)(7) of the Internal Revenue Code (Code).

FACTS:

The information submitted on your application, Form 1024 discloses that you were organized as a non-profit corporation in the [REDACTED] on [REDACTED]. Your general purpose as stated in Article II of your Articles of Incorporation, is "to engage in any lawful act or activity for which a corporation may be organized under such law." Said purposes, as further clarified in your bylaws, are exclusively for pleasure, recreation and other nonprofitable purposes within the meaning of section 501(c)(7) of the Code.

On your application, Form 1024, page 2, part II, number 2, you list the following purpose and activities:

- you were formed for the purpose of maintaining and managing a private road within an area known as [REDACTED] in order to accomplish this defined purpose, on [REDACTED] you constructed and installed a gated access to the entrance of the private road to limit traffic through this community;
- your organization maintains and operates this gate;

CLERK	INITIALS	REVIEWER	REVIEWER	REVIEWER	REVIEWER	REVIEWER	REVIEWER
SLIP NAME	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
DATE	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

DEPARTMENT OF THE TREASURY INTERNAL REVENUE SERVICE CORRESPONDENCE APPROVAL AND CLEARANCE

FORM 1937-A (9-74)

U.S. GOVERNMENT PRINTING OFFICE: 1978-274-902

102 8800

the private road extending from the gate is repaired and maintained by your organization;

you have also installed space bumps

the utilities to operate this gate and all overhead expenses involved in the activities associated with the gate operation and road maintenance are paid for by your organization;

in the same endeavor, your organization is also working to preserve and protect the canyon on which this road is located;

You further disclosed that the [REDACTED] is not a membership organization. You stated that although it has had several business dealings with the [REDACTED], the organizations are completely separate.

In the supplementary information submitted you stated that you hold at least two general meetings annually, and publish a newsletter on a regular basis which is available to all at no charge. You further stated that the safe maintenance and control of [REDACTED] (the private portion) has led to increased fellowship both within the [REDACTED] Community and the general public on a more diverse basis in activities which include walking, jogging, bicycling, equestrians, and other city sponsored community events, conventions, conferences, and (filming) movies and the City sponsored [REDACTED].

Additional information from the area map you provided further shows that the "private road" which starts at the point where the card activated access gate was installed, is a section of the public road that runs through a private community from one end to the other. The road is a long stretch of public road except for that section of the stretch which is "private and gated."

Your corporation was granted easement rights by the city government relative to the maintenance and control of that section of the road. You have exercised your easement rights by installing a control access gate at the starting end of your "private road." The "private road" ends several miles down at the point where the public portion of the road resumes.

Your financial statements disclose that your only source of income is from the gate access fees, from the sale of gate access passes sold to area residents or property owners in the private community. (See Form 1024, page 2, part II, number 2).

ISSUE:

Does the organization qualify for exemption as an organization described in section 501(c)(7) of the Internal Revenue Code?

LAW:

Section 501(c)(7) of the Code provides exemption to clubs which are organized for pleasure, recreation, and other nonprofitable purposes, substantially all the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholders.

Treasury Regulation (Reg.), section 1.501(c)(7)(1)(a) provides that the exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Income Tax Regulations 1.501(c)(7)(1)(b) provides that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

Revenue Ruling 70-32, 1970-1 C.B. 132, denies exemption to a flying club whose sole activity involves the ownership, operation, and maintenance of the aircraft for use by the members. There is little commingling among members for social or recreational purposes. The club was organized to own and operate aircraft suitable for business or personal use by its members, improve their flying abilities, and, through the ownership, operation, and maintenance of flying equipment, provides economical flying facilities for its members. Membership is open to all persons who are interested in flying.

Revenue Ruling 58-589, 1958-2 C.B. 266, provides in part that for an organization to come within the provisions of section 501(c)(7) of the Code, it must establish (1) that it is a club both organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes and (2) that no part of its net earnings inures to the benefit of private shareholder or individual. To meet the first requirement, there must be an established membership of individuals, personal contacts, and fellowship. A commingling of the members must play a material part in the life of the organization.

Revenue Ruling 75-595, 1975-2 C.B. 214 describes a social club that provides social and recreational facilities to its members who are limited to homeowners of a housing development. The ruling stated however, that exemption would be precluded if any of the following services were provided by the club: (1) owning and maintaining residential streets, (2) administering and enforcing covenants for the preservation of the architecture and appearance of the housing development, and (3) providing police and fire protection and trash collection service to residential areas.

In the court case McGlotten v. Connally, 338 F. Supp. 448, 456 (D.D.C. 1972), the court stated:

"Congress has determined that in a situation where individuals have banded together to provide recreational facilities on a mutual basis, it would be conceptually erroneous to impose a tax on the organization as a separate entity. The funds exempted are received only from the members and any 'profit' which results from overcharging for the use of the facilities still belongs to the same members. No income of the sort usually taxed has been generated and the money has simply been shifted from one pocket to another, both within the same pair of pants."

ANALYSIS AND CONCLUSION:

The rationale in granting tax-exempt status to social clubs is grounded on the premise which enables individuals to pool their resources for the purpose of providing recreation and pleasure more effectively on a group basis and individually.

Your primary activity is operating, maintaining, and managing a private road with a control access gate. The primary focus for your claimed exemption is not based on pleasure, recreational, and other nonprofitable purposes under section 501(c)(7) of the Code. Further, you do not have members, organized activities that require membership of individuals, personal contacts, fellowship, and significant commingling among members. On the contrary, you stated that you are not a membership organization.

Also, the community oriented activities you mentioned such as walking, jogging, bicycling, equestrians, or community events,

etc., are not activities of your organization. Since you have no members, you have no commingling of members. The only common link to anyone in the area is the access to the gated private road to residents not wishing to go around the canyon areas via a longer route to reach the other end of the public road. Your primary purpose is to engage in the regular activity of operating a "toll road" or "access road" as a business undertaking.

Therefore, it is the position of the Internal Revenue Service that your organization does not qualify for exemption from Federal income tax under section 501(c)(7) because you do not meet the requirements of that section of the Code.

We have also considered your application for exemption as an organization described in section 501(c)(4) of the Code. The Facts remain the same.

ISSUE:

Does the organization qualify for exemption as an organization described in section 501(c)(4) of the Code?

LAW:

Section 501(c)(4) of the Internal Revenue Code exempts from Federal income tax an organization which fosters the common good and general welfare of the community and reads in part as follows:

"(4)...Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

Reg. section 1.501(c)(4)-1(a)-(2)(ii) states that an organization will be considered to be operated exclusively for social welfare purposes if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community, i.e., primarily for the purpose of bringing about civic betterment and social improvement.

Reg. section 1.501(c)(3)-1(c)(1) states that "An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals."

Reg. 1.501(a)-1(c) states "The word 'private shareholders or individuals' in section 501 refers to persons having a personal and private interest in the activities of the organization."

Revenue Ruling 74-99 provides that in order to qualify for exemption under section 501(c)(4) of the Code, a homeowners' association must serve a "community" which bears a reasonable relationship to an area ordinarily identified as governmental; it must not conduct activities directed to the exterior maintenance of private residences; and the common areas it owns and maintains must be for the use and enjoyment of the general public.

In Revenue Ruling 80-107, 1980-1 C.B. 117, an organization of persons that have an interest in shares of stock of public utilities in a certain state, which prepares statements on behalf of public utilities owned by its members for submission to administrative agencies and legislative bodies is not exempt as an organization described in Internal Revenue Code section 501(c)(4) because it is operating essentially for the private benefit of its members and is not primarily engaged in the activities for the common good and general welfare of the people of the community.

ANALYSIS AND CONCLUSION:

The concept of social welfare includes the provision of benefits to the community at large. The providing of benefits to a narrow group of recipients, in most instances, is not considered as promoting social welfare. Therefore, a social welfare organization may not, if it is to qualify for tax exemption, be operated for the private benefit of the organization's membership or other select groups of individuals or organizations.

Your organization does not serve an entire community but serves a narrow group of persons who reside or own property in a private area and who purchase gate passes to use the private road. Although there is a large community which abuts the gated area it is not a part of your private property or your organization. Therefore, it is the position of the Internal Revenue Service that your organization does not qualify for exemption from Federal income tax under Code section 501(c)(4) as you are primarily operated for the private benefit of those persons purchasing gate passes.

Accordingly, you are required to file income tax returns on Form 1120, U.S. Corporate Income Tax Return, annually with your respective Service Center beginning with tax year ended December 31, 1995.

If you are in agreement with this proposed determination, we request that you sign and return the enclosed agreement Form 6018. Please note the instructions for signing the agreement on the reverse side of the form.

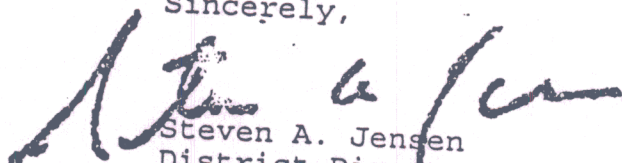
If you are not in agreement with this proposed determination, we recommend that you request a hearing with our office of Regional Director of Appeals. Your request for hearing should include a written appeal giving the facts, law, and any other information in

support of your position as explained in the enclosed Publication 892. You will be contacted to arrange a date for a hearing. The hearing may be held at the Office of Regional Director of Appeals, or if you request, at a mutually convenient District Office. A self addressed envelope is enclosed.,

If we do not hear from you within 30 days from the date of this letter, and you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies and will then become our final determination.

If you have any questions, please contact the person whose name appears on the heading of this letter.

Sincerely,



Steven A. Jensen
District Director

Enclosures:
Form 6018
Publication 892